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Docket: UT-031033
Company: Telecommunications - General

Staff: Kristen Russell, Telecommunications Analyst
Erin Hannan, Telecommunications Analyst
Robert Shirley, Telecommunications Policy Analyst
Glenn Blackmon, Assistant Director - Telecommunications

Recommendation:

Establish the telephone assistance rate for local exchange companies at \$8.00 per month, effective August 1, 2003.

Background:

The Washington Telephone Assistance Program (WTAP) provides a discount on basic telephone service to low-income households in the state. The Department of Social and Health Services (DSHS), which administers the program, on June 25, 2003, proposed to increase the rate that participants pay for telephone service from \$4.00 per month to \$9.00 per month.

In requesting the increase, DSHS said that a higher rate is necessary to ensure a balanced budget for the program for the long-term. It stated the fund experienced increased program expenditures due to greater client participation and payments to high cost telephone companies. DSHS has recently taken steps to regain control of program expenditures by limiting the reimbursement to high-priced resellers. More detail on program history and expenditures is contained in Commission Staff's Open Meeting Memo of July 9, 2003.

The WTAP program serves approximately 135,000 low-income households, or about 5-6 percent of all households in Washington. According to a report published by the Federal Communications Commission earlier this year, only four states rank higher than Washington in the percentage of low-income households with telephone service. By contrast, Washington's ranking for telephone penetration among all households is 17th.¹ While DSHS administers the WTAP program, the WUTC is responsible for establishing the rate that participants pay for telephone service. *RCW 80.36.420(3)(a)*. It also sets the excise tax rate that funds the program. *RCW 80.36.430, WAC 480-122-060*. The excise tax rate applies to all switched access lines in the state and may not exceed \$0.14 per month. The rate currently is \$0.13 per month.

¹ *Telephone Penetration by Income by State*, May 2003, Federal Communications Commission < http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/pntris02.pdf >. It should be noted that the state-level rankings are subject to considerable uncertainty because they are based on a survey. For example, the overall Washington value of 96.3 percent for 2002 has a confidence interval of plus or minus 2.3 percent. The confidence interval for the low-income Washington value of 94.4 percent for 2002 is not reported but would be even larger.

The request by DSHS is significant both in its size and in the number of people who would be affected. By comparison, the 18 smallest incumbent local exchange companies in the state collectively serve approximately 87,500 lines, or about two-thirds of the WTAP number.

Public Comments:

More than 1,500 participants contacted the WUTC to express opposition to the increase, particularly the size of the increase. A few people stated their support for a smaller increase if it were necessary to keep the program operating.

Many people commented that the proposed increase would result in a loss of money for food, medicine and even the possibility of having to disconnect phone service. Participants commented that telephone service is no longer a luxury but rather a necessity. The majority of the contacts stated they are disabled or elderly and depend on the phone for their lifeline. Many participants also indicated they are on a fixed income without other means available to afford the increase.

Analysis:

Since the formal request was made on June 25, Commission Staff has worked closely with the DSHS program staff and various stakeholders to understand the basis for the increase from \$4.00 to \$9.00 and the impact of this increase on program participants.

In analyzing options, Staff has taken care to account for the loss of federal universal service support that will result from an increase in the WTAP participant rate. DSHS estimates that its proposed increase to \$9.00 would cause a reduction in federal funds of \$1.6 million. At the margin, the rate for low-income households has to increase by \$1.50 for every \$1.00 of savings to the WTAP fund.

The requested increase is driven by several factors, the most important of which are:

1. Funding existing benefits to existing participants. The WTAP program has operated at a loss since 1999, when the participant rate was reduced from \$7.50 to \$4.00. The operating loss was a deliberate policy; the state chose to pay more in benefits than it received in revenues in order to reduce a large reserve that had accumulated in the fund. The reserve resulted, at least in part, from the state's effort to prepare for a large increase in local rates that was requested in 1995 but was never approved.

The WTAP fund now has a balance that is approaching zero. Therefore, Staff believes that there is no doubt about the need to increase the WTAP rate so that the program expenditures no longer exceed revenues. Staff believes that a WTAP rate of \$8.00 per month would be sufficient to fund the program at the existing benefit level (i.e., no voice mail) and existing

participation level. It also would provide some cushion for uncertainties such as caseload growth.

2. An expanded program. The Legislature earlier this year expanded the WTAP program to provide voice mail service to the homeless. This program expansion addresses the telecommunications needs of people who, because they have no home, cannot benefit from the WTAP. The Legislature authorized DSHS and the Department of Community, Trade, and Economic Development (DCTED) to spend up to 8 percent of program revenues on community voice mail. For Fiscal Year 2004, 8 percent would be about \$418,000.

About \$0.40 of DSHS' requested increase to \$9.00 is attributable to the costs of the voice mail program. DSHS assumed it and DCTED would agree to a funding level of \$400,000.

Staff recommends that no voice mail program costs be included in the WTAP rate at this time. DSHS and DCTED have not yet agreed on a funding level. Staff recommends that the WUTC wait until those agencies have determined the voice mail funding level. At that time, the WUTC could consider either increasing the participant rate (by an amount up to \$0.40 per month) or increasing the excise tax rate by \$0.01 to the statutory cap.

3. Anticipated growth in program participation. DSHS has projected that program participation will increase, despite the higher rate for participants and despite a program change that took effect on June 1, 2003. The program change reduced the amount of money that competitive local exchange companies could receive from WTAP.

While participation did increase significantly in FY 2003, Staff believes that it is reasonable to assume that it will grow much more modestly in the future. Much of the recent increase is due to active marketing by competitive local exchange companies that expected to receive about \$50 per month from WTAP. Effective June 1, the reimbursement was \$5.00. It will drop to \$1.83 if the WUTC sets the participant rate at \$8.00 and to \$1.17 if the WUTC sets the participant rate at \$9.00.

In addition, the higher participant rate will directly affect the likelihood of eligible customers to sign up for the program. Already most low-income households who have telephone service do not receive WTAP benefits. Eligible households will be less likely to use the program if the benefits are lower.

In arriving at the recommendation for a rate of \$8.00, Staff used the same projected participation level as DSHS. If an even lower participation level of 120,000 were assumed, the WTAP rate could be about \$7.65. Thus, the recommended rate includes about \$0.35 as a contingency to cover the potential

growth in the program. If this growth does not materialize, the \$8.00 rate would provide about \$300,000 of net revenues that would contribute to a WTAP reserve.

4. A restored fund reserve. DSHS proposes to set the WTAP rate above the level necessary to pay program and administrative expenses so that it can rebuild a reserve balance in the WTAP fund. DSHS believes that a reserve equal to six months of expenses, or about \$2.5 million, is appropriate. Funding a WTAP reserve is expensive due to the loss of federal funds, as noted earlier. Program participants would have to pay \$3.75 million in higher telephone rates to provide a \$2.5 million reserve.

At the \$8.00 level recommended by Staff and using DSHS' projection of caseload, there would be little or no contribution toward a WTAP fund reserve. However, as discussed below, there may be other options that DSHS could take that would permit the creation of a reserve even at the \$8.00 rate.

The results of Staff's analysis are presented in Attachment A.

Other Program-Level Changes:

As noted above, Staff recommends that the WUTC minimize the size of the increase to program participants at this time. This recommendation is based in part on the desire to impose as little burden on low-income households as possible but also in recognition of the possibility that the state can implement cost-saving or revenue-increasing changes to the program.

Possible changes to the program include:

- More frequent screening of participants. By statute, eligibility for WTAP is based on eligibility for other income-qualified programs administered by DSHS. DSHS currently removes ineligible WTAP participants once per year, in July. It estimates that about 11 percent of participants are removed in this process. Screening eligibility semi-annually or more frequently could reduce program expenses by 3 percent or more.
- Increased tax collections. DSHS estimates that in Fiscal Year 2003 it collected the WTAP excise tax on 3.35 million access lines. It projects that in Fiscal Year 2004 it will collect tax on 3.2 million lines. This represents a decline in revenue of \$228,000 per year. Staff has used the lower revenue level in recommending an \$8.00 participant rate. However, Staff also notes that the Department of Revenue (DOR) collects the state E-911 excise tax on more than 3.5 million switched access lines. Staff understands that DSHS plans to begin cross-checking its tax receipts with the DOR data but that this effort has not yet begun.
- Greater participation in the federal program. As discussed above, the federal low-income program is available to pay for a significant portion of the reduced rate to

WTAP participants. However, the federal support is not available to telephone companies that are not designated as eligible telecommunications carriers. Staff understands that, if a company is not designated as eligible, DSHS generally reimburses that company for the funds not received from the federal program. Program expenses probably could be reduced by requiring that companies obtain all available federal funding, but neither Staff nor DSHS has estimated the amount of potential reduction.

- Use of a single contractor. DSHS currently operates the WTAP program by dealing directly with virtually every company that offers local service to residential customers. There may be efficiencies to be gained by using a different program model, in which DSHS contracted with a single telephone company to serve all WTAP customers. Neither Staff nor DSHS has made an estimate of potential savings from this approach.

WTAP Excise Tax Rate:

Several stakeholders have taken issue with the decision of DSHS to propose an increase in the client rate and propose no increase in the excise tax rate. Increasing the tax rate by \$0.01 to the statutory limit of \$0.14 would produce approximately as much revenue as increasing the WTAP participant rate by \$0.40 per month.

Staff understands the reluctance to propose an increase in a tax. The Legislature recently enacted a state general fund budget that required very large cuts in programs and benefits; these cuts were necessary because there was not sufficient support to raise taxes. This suggests that the overall public policy of the state at this time is to avoid increasing taxes and to live within existing means.

However, it is also worth noting that, in reauthorizing the WTAP in the 2003 session, the Legislature retained the excise tax limit at \$0.14 and required an increase in program expenses of up to 8 percent.

The question of whether to raise the excise tax or to raise the participant rate, particularly with an increase in the scope of the program, is a high-level policy question for the Commission. However, because the costs of the voice mail program have not yet been determined, Staff recommends that the Commission wait to decide whether to increase the excise tax rate. Once those costs are known, the Commission can decide whether to pay for that program expansion by increasing the tax rate or by decreasing benefits to existing participants.

Ongoing Monitoring:

If the Commission decides to increase the WTAP participant rate to \$8.00 rather than \$9.00, Staff recommends that it work closely with DSHS to monitor the status of the WTAP fund and program expenditures. The lower participant rate would require that the program operate closer to the edge of fiscal solvency. Should conditions change for the

worse, an additional increase in the participant rate may be required. DSHS and the WUTC should be prepared to act quickly to keep the program solvent.

Summary

Staff believes that, while there is considerable uncertainty about the future level of program expenses, an increase of the WTAP participant rate to \$8.00 is sufficient at this time. This rate level probably is not sufficient to fund the expansion of the program to include community voice mail, so if the Commission approves the \$8.00 rate, it would likely need to consider later how to pay for that program.

Attachment A - Alternative Calculations of WTAP Participant Rate and Program Net Revenue

	<u>Current Rate</u>	DSHS	Staff Recommendation	
		<u>Proposed</u>	<u>No Growth</u>	<u>With Growth</u>
WTAP Participant Rate	\$4.00	\$9.00	\$7.65	\$8.00
Federal Universal Service Support	3.50	2.42	2.85	2.74
WTAP Cost per Participant	<u>5.29</u>	<u>1.37</u>	<u>2.28</u>	<u>2.05</u>
Total	\$12.79	\$12.79	\$12.79	\$12.79
Average Participants	131,704	131,704	120,000	131,704
Projected Program Revenues	\$5,000,000	\$5,000,000	\$5,000,000	\$5,000,000
Projected Program Expenses				
DSHS Administration	500,000	500,000	500,000	500,000
Tel. Company Administration	225,024	225,024	225,024	225,024
Connection Charges	978,264	978,264	978,264	978,264
Monthly Benefits	8,355,063	2,157,599	3,288,896	3,233,207
Community Voice Mail	<u>400,000</u>	<u>400,000</u>	-	-
Total Expenses	10,458,351	4,260,887	4,992,184	4,936,495
Projected Net Revenue / Reserve Contribution	-\$5,458,351	\$739,113	\$7,816	\$63,505